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Development planning should reflect our understanding (and theory) of how economic development occurs. Economic development thinking has evolved significantly since development planning was introduced. The emphasis in economic development has evolved from a focus on narrow capital shortages, to human capital development and most recently incentives in the context of institutional and organizational change. The role of government has also evolved. Initially the central government was seen as the only actor who could effectively achieve broad development objectives, but policy failures led to a more pessimistic view about this model and even government objectives. Most recently, a more neutral view of government seems to be evolving. Nevertheless, effective strategy on the part of government, at whatever level, requires improved understanding and careful analysis to avoid inappropriate interventions. The goals of development have also changed from a focus on income, to income adjusted by income distribution/poverty, to a larger set of welfare indicators. This area is still controversial. One side argues that development (or economic development) is sufficiently captured by income adjusted for distribution, with the other claims the need for more extensive indicators. Changes in planning have to, and have, evolved with these changes in thinking about economic development. As economic development thinking evolves plans evolve as well. They are now shorter, tighter, more issue oriented and subject to performance indicators. The recent Indonesian government Propenas is in line with this trend.

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Economic Development
and
Development Planning:
A Short Note

By William Wallace, Ph.D.[1]
August 27, 2001

Abstract

Development planning should reflect our understanding (and theory) of how economic development occurs. Economic development thinking has evolved significantly since development planning was introduced. The emphasis in economic development has evolved from a focus on narrow capital shortages, to human capital development and most recently incentives in the context of institutional and organizational change.

The role of government has also evolved. Initially the central government was seen as the only actor who could effectively achieve broad development objectives, but policy failures led to a more pessimistic view about this model and even government objectives. Most recently, a more neutral view of government seems to be evolving. Nevertheless, effective strategy on the part of government, at whatever level, requires improved understanding and careful analysis to avoid inappropriate interventions.

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Introduction

The goals and means for economic development planning depend on our understanding of how economic development (and development more broadly) occurs. Core concepts in development planning emerged about 50 years as integral element of the ideology(s) of the time.[2] However, economic development strategy, and basic goals have changed over time and planning has, and has to, evolve with them.

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[2] Planning more broadly emerged earlier in communist/socialist countries. Baghchi, (pg. 98).

This is a particularly critical and interesting moment to reflect on and assess the role of economic planning. First, Indonesian development strategy and planning deserve credit for documented Indonesian successes from the 1970s to the mid 1990s but must also be assessed in the aftermath of the crisis and response. Second, globalization and decentralization are powerful forces changing the role of national governments and necessarily affect strategy and goals. Political and technological trend and development transform the economy reducing the central government role. This should result in changing strategy and policy toward incentive regimes and institutional and organizational issues.

I cannot cover all of the topics of interest here, and this short note is limited to a brief sketch of the evolution of the economic profession's thinking on economic development and some conclusions for economic planning broadly.[3] I do include a short description of whether a focus on economic development is sufficient, but do not draw any real conclusions. The final section has some personal observations on planning in Indonesia. The issues of what a better planning system could or could have done in the context of the crisis, and the more specific role of the planning ministry in the future are addressed elsewhere.

Economic Development[4]

The first generation

The world appeared to be a different place in the 1950's. The Keynesian revolution in mainstream economics left its mark broadly and there was a sense that the economic profession understood what was required to achieve and maintain macroeconomic stability. The Marshal plan, designed to get Europe and Japan back on their feet, was succeeding. And while growth was not central to Keynesian economics, the optimism it generated led to extending the focus to developing countries. In addition many newly independent countries in Asia and Africa sought advice from academics in Europe and America on what they should do. In response, "They [the academics] formulated grand models of development strategy that involved structural transformation and a correlative role for extensive government involvement in development programming or planning." The core idea in most of the thinking was that economic development was based on accumulating and adding physical capital, capital being the binding constraint.[5]

In fact the simple logic was that developing countries could, and should, grow faster than developed ones. The addition of a fixed amount of capital to the larger labor share generates higher returns due to diminishing marginal productivity and should lead to convergence in international incomes. Given notions of equity this was and remains one of the underlying pulls of economic development.

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[3] While there is a mainstream or central view there are, of course, basic disagreements about of the goals and means of development (economic and otherwise). In fact these disagreements are often central to national and international political debates. The substance of the discussion here traces the mainstream view.

[4] While this section draws extensively on Meier (2001) it does not begin to do it justice and the reader is encouraged to read his review. I am not an expert on this material and can only draw out some of the themes and try and relate them to the role and goals of planning.

[5] Intellectually this was built on the Harrod-Domar equation (Meier footnote 4, pg. 40). The ICOR (incremental capital output ratio) is based on this concept.

Further,

"The models and hypotheses had policy implications that involved strong-state action. To many of the early development economists, a less-developed economy was characterized by pervasive market failures. To correct or avoid market failure, they advocated central coordination of the allocation of resources." And "Believing that a developing country did not have a reliable market price system, that the supply of entrepreneurship was limited, and large structural changes – not merely marginal adjustments—were needed, the first generation of development advisors turned to the state as the major element of change."

Pessimism about the ability of these countries to export, and an urge to accelerate industrialization also led to import substitution and inward looking growth. Finally, the need for capital and the pessimism about the role of the private sector motivated a demand for official capital flows as a (the) key mechanism to accelerate growth.

By the late 1960's early 1970's the ideas behind this view of economic development were under attack. The Solow growth model [published in the 50's] introduced the notion of total factor productivity growth.[6] Although the central concept (total factor productivity itself) was characterized as "the measure of our ignorance" theoretically and empirically it introduced the thought (and empirical confirmation) that there was more going on than adding physical (much less financial) capital. In particular of importance was human capital; education, skills, and health status. In addition there was a widespread belief that the "grand-strategies" were not succeeding. There had not been any rapid improvement in poverty or a speed up in growth, and, if anything, income was becoming more unequal.

Thus, the notion of market failure was replaced with the notion of "non-market" failure, usually another word for government policy failure. "As Timmer (1973) expressed it, 'getting prices right' does not guarantee economic development, but 'getting prices wrong' frequently is the end of development."[7]

The Second Generation

Economists working on development in the Second Generation were not sympathetic to the a-theoretical grand theories of the First Generation. And they were even more negative about the effectiveness of <u>direct</u> government intervention than they were about the market failures that had motivated these interventions in the first place. Their contention was that the tools of Neo-classical economics could be brought to bear on the issues in developing countries. They did not accept the fundamental assumption of the previous generation that economic rationality did not characterize poor farmers in developing countries "A country was not poor because of the cycle of poverty but because of poor policies."

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[6] Total factor productivity breaks out economic growth into changes in the underlying factors, labor and capital. However, empirically these do not entirely, or often even largely explain growth. Thus the residual, also called total factor productivity explains the rest.

[7] As quoted in Meier (pg. 17).

The theory of the State was elaborated as well. Theories of political economy were extended well beyond first generation models of a single benevolent actor. In this view the state (or the bureaucracy), with insufficient checks and balances often ends up using proposed or existing interventions to transfer resources to selected interest groups including themselves.[8]

Thus, in the view of many there were no unique issues in development economics and no need for a special field.

"Once it is recognized that individuals respond to incentives, and that 'market failure' is the result of inappropriate incentives rather than non-responsiveness, the separateness of development economics as a field largely disappears. Instead it becomes an applied field, in which the tools and insights of labor economics, agricultural economics, international economics, public finance and other fields are addressed to the special questions and policy issues that arise in the context of Development."[9]

The poor economic returns to high savings in many countries forced a reevaluation of the sources of growth and changed the focus from the amount of savings to its efficient allocation. "The correct policies were to move from inward-looking strategies toward liberalization of the foreign trade regime and export promotion; to submit to stabilization programs; to privatize state-owned enterprises; and to follow the dictates of the market price system. Through its guidance toward the correct policies, neo-classical economics was believed to be the safeguard against policy-induced distortions and non-market failures."

These concepts were in place during the 1980s and 90s and are the core of "the Washington Consensus", based on location of the World Bank and IMF, which were critical to spreading and extending this framework from academia. This has been and probably remains the dominant paradigm in recent years.

During the 1980s elaborations on the Solow growth model under the Endogenous Growth model, extended the earlier concept beyond capital accumulation and human resource investment. A broad research agenda has concentrated on what societies (and governments) have done that has systematically affected the ability to grow, i.e. to endogenize the residual. This literature continues to evolve and insights are innumerable. However, perhaps the most important has been an emphasis on learning, and the role that institutions and institutional change play in creating and maintaining incentive regimes (both good and bad).[10]

The "New" Development Economics

The last few years have seen the return to a more balanced view of the role of government in the context of market and non-market failures. Insights from this literature are based on a careful analytical work, improved understanding and clear documentation of "new" market failures. These failures are typically based on imperfect and costly information,

[8] Meier makes the general point on pg. 20-21. Hla Myint in his comment goes so far as to predicate a "predatory state". Myint's comment on Meier's chapter, pg. 59.
[9] Meier quoting Ann Kreuger, pg. 18.
[10] This insight is drawn from the Nobel Prize winning work associated with North (1990).

incomplete markets (especially insurance), transactions costs and the absence of futures markets.[11] In particular there has been an emphasis on the role that these failures have played in hindering agricultural and financial sector growth in developing countries.

Analysis of these issues combined with the insights of endogenous growth on learning and institutions are being used to challenge the perceived "anti-government" stance of the Second Generation. Nevertheless as Meier says, "Although a more meaningful case can be made for a "big push" or for "balanced growth", the experience with government failure has remained dominant in weighing against government intervention. Designing and implementing interventions designed to rectify "new" market failures, or promote learning or institutional change from the endogenous growth literature remain difficult.

Paraphrasing North, Meier says: "we now know a good deal about what makes for successful development, but we still know very little about how to get there – and especially how to establish the institutional and organizational structure that will support the desired rate and composition of economic change."[12]

The Goals of Development

Debraj Ray sets the issue up the issue of our focus well in the opening of the first chapter of <u>Development Economics</u>.

"By the problem of economic development I mean simply the problem of accounting for the observed pattern, across countries and across time, in levels and rates of growth in per capita income. This may seem too narrow a definition, and perhaps it is, but thinking about income patterns will necessarily involve us in thinking about many other aspects of societies too, so I would suggest that we withhold judgment on the scope of this definition until we have a clearer idea where it leads us." –
R.E. Lucas (1988)

"[W]e should never lose sight of the ultimate purpose of the exercise, to treat men and women as ends, to improve the human condition, to enlarge people's choices … [A] unity of interests would exist if there were rigid links between economic production (as measured by income per head) and human development (reflected by human indicators such as life expectancy or literacy, or achievements such as self-respect, not easily measured. But these two sets of indicators are not very closely related." –
P.P Streeten (1994)

The quotes depict the conflict between broader and narrower goals for economic development and even development more broadly. There is probably a consensus that growth alone, taken narrowly as growth in per GDP, does not capture the goals of society. However, the question remains as to whether an augmented income growth definition, augmented with a focus on poverty and income generation, is sufficient. The first school of thought would argue that,

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[11] The recent textbook by Debraj Ray (1998) "Development Economics" is a good comprehensive source of information on this area.
[12] Meier, pg. 23.

while there is no single solution, an income distribution adjusted measure of overall income growth is sufficient to proxy overall economic development because it makes possible, even likely, progress in the other dimensions of development. [13] This progress on a broader set of indicators occurs naturally due high income elasticities for other indicators, perhaps including income distribution. Ultimately that it must be in the interests of the better off to make sure that the worse off gain as well. The stronger the weight on income distribution, as opposed to per capita income the lower the belief that this may be true.

Others argue that income (even with distribution) is not sufficient, implicitly due to the lack of correlation mentioned by Streeten, and that the better off are not implicitly interested in the welfare of the less well off. If so, we need to move beyond these to other welfare indicators. Thus the United Nations through the Human Development Indicators (HDI) proposes that the goals of economic development cannot be separated from wider goals often health status and participation in education and other areas. This can also include widening people's choices through participation and democracy. The most recent World Bank effort in their Comprehensive Development Strategy (CDF) would also appear to be in line with broadening the goals of development.

The CDF framework is also interesting in that it proposes a development strategy organized around issues, with a clear structure that defines the actors central and local government, domestic and foreign responsible for achieving the goals indicated.

Thus, generally speaking there has been an evolution in thinking about the goals of development to include the distribution of income and alleviation of poverty at a minimum, and usually broader indicators of welfare.

Economic Development and Planning

So what do these changes in the goals and means of "economic development" mean for planning? Any plan would have many objectives, but primary ones might be a consensus on society's goals, and a framework or broad strategy on how to achieve them. More narrowly such a plan (or development program) provides guidance for those in government and the private sector. Such guidance is important as ideas shift and resource constraints rearrange tasks. For example, all over the world, jobs that were once the central governments are now given to lower level governments and the private sector.[14] Nevertheless the government's own budget plans and particularly capital spending (for example, major infrastructure) remain important.

Clearly our view of what should be in a plan has changed over the last half century. Economic development thinking fifty years ago dictated that goals and strategy emphasize the government (central) doing much of the work and plans were often elaborate and detailed (even excessively so). Further, due to the perceived capital shortage and weaknesses of the private sector plans emphasized sectoral (often industrial) development through foreign official borrowing and inward looking, protectionist strategies.

[13] This might be inferred to be Ray's position, pg. 44, in Economic Development, and is
[14] With globalization, some functions may also be seen to be devolving toward multinational organizations, trade for example.

With the skepticism about government failure these plans fell into disrepute among mainstream economists. While many countries continued to produce plans they shifted emphasis. The idea of seeking and agreeing to a consensus on national priorities has generally been retained. However, this has often become more complicated as democratic institutions have evolved. For example, as parties compete during elections they can and often do develop and promote their own platforms.

On the strategy side plans are evolving toward a clearer focus on national issues expected over the planning period and the strategy to achieve the goals in these areas. This latter emphasis requires clear definitions, better analysis of sectoral strategies and options, and especially more careful consideration of the costs and benefits of and appropriate level (local, regional, national) of government intervention. Thus it appears that planning/programming are in line with changing economic development thinking. However, effective strategy that takes into consideration institutional and organization change remains exceedingly difficult as discussed above.

A paradigm shift? – From Repelita to Propenas

There is not time to go over the differences in planning as represented by Repelita and Propenas in Indonesia. Such a comparison would raise far too many issues to deal with effectively in a short piece. However, it does appear that Propenas' (and Repeta's) focus on issues and policies (even across sectors) and its concern with measuring results is in line with the changes in economic development thinking. The Propenas format, and its embodiment in the Repeta appears to be more issues oriented, limited to fewer more important priorities and better focused on the role of government policy as it effects the private sector.

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